

# NAVAL POSTGRADUATE SCHOOL

## Monterey, California



**THESIS**



**THE CHIEF FINANCIAL OFFICERS ACT OF 1990  
AN ANALYSIS OF ITS IMPLEMENTATION  
WITHIN THE DEPARTMENT OF DEFENSE**

by

E. Charles Buckner

December, 1994

Principal Advisor:

Jerry L. McCaffery

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An Analysis of its Implementation within the  
Department of Defense

by

E. Charles Buckner  
Major, United States Marine Corps  
B.S., University of Southern California, 1980

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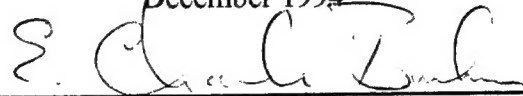
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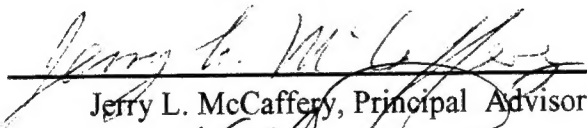
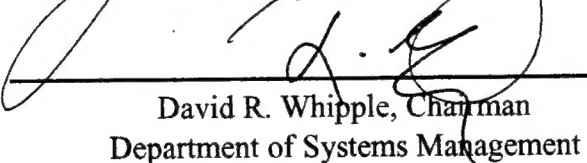
December 1994

Author:



E. Charles Buckner

Approved by:

  
Jerry L. McCaffery, Principal Advisor  
James M. Fremgen, Associate Advisor  
David R. Whipple, Chairman  
Department of Systems Management

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## **ABSTRACT**

This Thesis is about the implementation of the Chief Financial Officers Act of 1990 in the Department of Defense. This Act sought to focus the federal government into four critical realms of fiscal concern. They are accountability, organizational structure, management planning and performance, and quantification of programs, performance, liabilities and investments. By the middle of 1994 the Department of Defense has aggressively instituted significant reform in its organizational and methodology infrastructure to begin to meet the criteria established in the Law. This thesis focuses on those measures detailed by the Office of Management and Budget which the Department of Defense has instituted to refine and manifest its implementation of the Act: accountability standards, financial management organizations, financial management personnel, financial systems, management controls, asset management, and audited financial statements.

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## I. INTRODUCTION

During the waning hours of November 20th 1990, the 101st Congress enacted the Chief Financial Officers Act into public law. This was the culmination of a decade's worth of labor by both the legislative branch and the private sector to improve the federal government's performance in financial management. Its goal was to "strengthen the general management activities of the Office of Management and Budget(OMB) by creating a Deputy Director for Management position and clarifying OMB's general management statutory authority, and to improve financial management activities across the Federal Government" [Ref. 3:p. 56]. To accomplish this action the CFO Act would focus the federal government into four key areas of fiscal concern. These are:

- ♦ Accountability
- ♦ Organizational structure
- ♦ Management planning and performance
- ♦ Quantification of programs, performance, liabilities, and investments

Passage of the Act established a primary accountable official as the Chief Financial Officer (CFO) in OMB, concurrently mandating the emplacement of CFOs in 23 departments and agencies of the federal government. These departments and agencies specified in the law will be identified in Chapter II. It required the principal executive agency, the Office of Management and Budget (OMB), to develop financial management plans, which it was to disseminate to the 23 other CFOs as a bench mark from which

to develop their plans, tasking all with the requirement of producing annual progress reports. The most significant report is that of OMB, "The Federal Financial Management Status Report and 5-Year Plan". The Act's final challenge to the federal government was the transition toward financial statements that would classify costs, provide corresponding measures of performance and be useful as predictors for future liabilities and return on investments. The federal government now by law was and is tasked to produce auditable financial statements.

The passage of this legislation, championed by Senators Glenn and Roth and Representatives Horton and Conyers, represents a major step in improving the quality of federal financial management. Some feel that this Act is the most significant piece of fiscal structure legislation, since the Dockery Act of 1894; it is as broad and as encompassing as the Budget and Accounting Act of 1921. The Department of Defense (DOD) as one of the larger and more diverse agencies of the federal government, responsible to the American people for the proper allocation of 17% of the Federal Budget (FY94), has been presented with a challenge of Herculean proportion: auditable financial statements. To date DOD has yet to reach the goal of an unqualified audit opinion. This opinion, normally defined as an auditor's standard report, is given after gathering sufficient evidence about an entity's financial position and operations. Only then, if the auditor is satisfied that the financial statements are fairly presented in conformity with generally accepted accounting principles, will he issue an unqualified audit opinion. [Ref. 12:p. 10]

## **A. RESEARCH QUESTIONS**

- ♦ The Primary Research Question is:

How have the guidelines of the Chief Financial Officers Act of 1990 been implemented within the Department of Defense?

- ♦ The Subsidiary Research Questions are:

What benefits have the requirements for the annual audits produced for financial management within the Department of Defense?

How has the Department of Defense fared in meeting the seven critical elements outlined by the Office of Management and Budget?

## **B. SCOPE OF THE THESIS**

The purpose of this thesis is to (1) delve into the background from which the CFO Act is derived, (2) review what DOD is tasked with in implementing the tenets of the Act, (3) compare available data on the success of DOD in producing auditable financial statements, (4) determine the compliance initiatives of DOD, and (5) compare these initiatives to that of the Office of Management and Budget's seven critical elements for the reform of Federal Government financial management.

## **C. METHODOLOGY**

Research data was obtained through the review of published academic writings, periodicals, Public Hearing reports by Congress, and memorandums of record from the Department of Defense, and by telephonic interviews with selected members of OMB, committee Staff members, DOD CFO staff workers, as well as

staff of the CFO's for selected departments, agencies and government corporations used for comparison to the Department of Defense.

#### **D. BENEFITS OF THE STUDY**

The Department of Defense and all military services will benefit from this study. The in-depth look at where DOD is in its implementation of the law, the analysis of its compliance with the Office of Management and Budget's directives and its current efforts will enhance DOD's exertions in the production of reliable financial statements which present a fair appraisal of the department's effort in managing those appropriated dollars entrusted to its care.

## **II. HISTORY OF FEDERAL FINANCIAL MANAGEMENT**

### **A. INTRODUCTION**

The Chief Financial Officers Act (CFO) has been described as the most significant improvement to federal financial management since the passage of the Dockery Act in 1894. This act established individual agency auditors and specifically addressed the establishment of reporting standards and financial control over agency expenditures, assigning all these responsibilities to the Treasury Department. [Ref. 23:p. 9] With the passage of time and the growth of the federal government, Congress became concerned regarding the accuracy of the information being provided by the Executive Branch. To improve this, a series of Acts were voted into law. Beginning in 1921, the Budget and Accounting Act established, among other things, the General Accounting Office (GAO) and transferred to it from the Treasury Department the responsibility for the establishment of accounting and reporting standards of the U.S. Government. The GAO issued its "Policy and Procedures Manual for the Guidance of Federal Agencies". Title 2 of this manual dealt with accounting principles and standards. Reporting was oriented to providing information requested by the Congress. Still Congress was not completely satisfied as to the financial reporting of the federal government. In 1950, Congress enacted the Budget and Accounting Procedures Act. The Act stated:

- ♦ The Comptroller General was to prescribe the principles, standards and related requirements for accounting and approve the systems of accounting and reporting;

- ♦ Treasury was responsible for establishing a system of central accounting and reporting and requiring agencies to prepare reports on their financial conditions and operations;
- ♦ The Bureau of Budget was to direct the actions of agencies to achieve consistency in accounting and budget classification, synchronization between accounting and budget classifications and organizational structure and support budget justifications;
- ♦ The head of each agency was to develop systems and controls.  
[Ref. 26:p. 6-7]

Its purpose was to require improved accounting systems in the federal agencies [Ref. 23:p. 14]. Federal agencies, however, continued to operate at the status quo, which was financial management by the annual budgeting process as opposed to program management and financial management integrated in a single useful system.

## **B. THE PRIVATE SECTOR AND GOVERNMENT DEVELOPMENT**

The Federal Government's financial system has been compared to that of the private sector as a three phase evolutionary process. Where the private sector has gone through each phase of development, the Federal Government has yet to advance through phase two. The first phase has been equated to the period of this country's industrial revolution, agriculture growth and industrial development. The second phase is similar to that of single product companies, while the third phase would parallel the multi-product companies and global markets. Each phase of the private sector development can be compared to the growth in federal government financial responsibilities. The main

difference, observed W.L. Kendig (Deputy CFO, Interior), is that the federal government made no significant improvement to its system of financial management after 1950 [Ref. 23:p. 9].

### **C. POST 1950 LEGISLATIVE ACTION**

The federal deficit and the failings of the current system led many in the early 1980's to begin critically evaluating the methodology of doing financial business. As a result of hearings held by the House Committee on Government Operations, and the Senate Committee on Governmental Affairs, numerous General Accounting Office and Office of the Inspector General reports, and concern by the Association of Government Accountants, the need for financial management reform was determined to be great.

The failure to detect problems quickly enough to remedy a situation was exemplified by the savings and loan crisis. Consequently the GAO and OMB conducted studies of high risk programs and by 1989 identified 78 potential problems which might pose liabilities of hundreds of billions of dollars.[Ref. 2:p. 14] These concerns led to the introduction of several legislative proposals. The first, sponsored by Representative Dioguardi, was introduced in March of 1986. H.R. 4495, the Federal Financial Management Improvement Act, proposed the establishment of the Office of the Chief Financial Officer of the United States in the Executive Office of the President. The bill further proposed the establishment of the Office of the Assistant Secretary for Financial Management within each executive department and an Office of the Controller in each executive agency. Senator Glenn during July of 1987 introduced S. 1987, the Financial Management

Reform Act of 1987. This bill would have created an Under Secretary of Financial Management in the Department of the Treasury, responsible for the development and implementation of a government-wide plan for an integrated financial management system. This bill would also create Chief Financial Officers in 22 agencies.

Reform 88, introduced by the Reagan Administration, was a far reaching program, whose purpose was to improve the management and integrity of the Federal Government. It led to the Prompt Payment Act, necessitating a mandatory billing cycle, electronic fund transfers, direct deposit and use of government credit cards. Generally accepted credit practices were instituted. These included the use of credit reports to screen loan applicants. System consistency and compatibility were fostered by the issuance of a standard ledger of accounts, a core requirement for accounting systems, further requiring each agency to have a single integrated accounting system. This led to a reduction by 50 percent in the number of federal financial systems.[Ref. 17:p. 12]

The Office of Management and Budget (OMB), during this period of change, continued to build on President Reagan's Reform 88. During 1990, it appeared that, although several pieces of legislation had been introduced, little consensus on this legislation appeared. OMB began an initiative in May of 1990, targeted at five program areas:

- ♦ Accounting standards and principles
- ♦ Financial information and systems functioning standards
- ♦ Agency financial systems



- ♦ Central agency financial systems
- ♦ Audited financial statements [Ref. 17:p. 12]

The results of these initiatives have been action oriented.

### **1. Accounting Standards and Principles**

In October of 1990, the Treasury Department, OMB director, and Comptroller General signed a Memorandum of Understanding establishing the Federal Accounting Standards Advisory Board (FASAB). This board consists of nine members. There is one representative each from the Defense Department, the International Agencies, the Treasury Department, OMB, GAO, and the Congressional Budget Office (CBO), three members come from non-federal organizations. The board is supported by a full-time professional staff and is charged with the formulation of recommendations concerning accounting standards and principles.

### **2. Financial Information and Systems Functioning Standards**

The second program, funded by OMB, induced the Joint Financial Management Improvement Program (JFMIP), staffed by the Treasury Department, OMB and GAO, to complete standard definitions for all financial data elements. Included in this project is the issuance of core accounting system standards, including standards for payroll/personnel and travel. The JFMIP was initiated in 1948; its core objectives are still current in today's financial management organization. These objectives are:

- ♦ Developing general objectives in those areas of common interest to the central agencies for guiding the improvement of financial management across government and promoting strategies for achieving those objectives.

- ♦ Reviewing and coordinating central agencies' activities and policy promulgation's affecting financial management to avoid possible conflict, inconsistency, duplication, and confusion.
- ♦ Undertaking projects and special reviews of significant problems and new technologies in financial management and publishing the findings and conclusions, often in the form of "best practices," as guidance to the operating agencies and with recommendations, if appropriate, to the central agencies.
- ♦ Acting as a catalyst and clearinghouse for sharing and disseminating financial management information about good financial management techniques and technologies.
- ♦ Reviewing the financial management efforts of the operating agencies and serving as a catalyst for further improvements.  
[Ref. 19:p. 1]

The JFMIP is key in mobilizing resources and coordinating cooperative efforts into the improvement of financial management practices [Ref. 19:p. 1].

### **3. Agency Financial Systems and Central Agency Financial Systems**

The third and fourth items, Agency financial systems and Central Agency Financial Systems, are long-term objectives. OMB's desire is for reports useful for policy and program managers, as well as being accurate and timely. Improving Central Agency Financial Systems has begun with the integration of Treasury and OMB financial data bases. These systems are known now as the Decision Support and Attributes for Reporting (DART) and the Tool for Analyzing Report Data, Graphing and Evaluating Trends (TARGET) systems, respectively [Ref. 20:p. 10].

#### **4. Audited Financial Statements**

The final program is the implementation of audited financial statements, specifically by the Cabinet Departments, the Environmental Protection Agency, and the National Aeronautics and Space Administration. These audited reports were expected by fiscal year 1994.

#### **D. EVOLVING THE CFO ACT OF 1990**

Beginning in 1950 and for four decades, the legislative and executive branches of government have recognized a fundamental weakness in Federal Government financial management. Decision makers at all levels of the federal government were not receiving the needed financial data, whether timely or not, to effectively make policy and management decisions; nor do they know the ultimate fiscal impact of those decision. Decision making has been further inhibited by the split within the executive branch between OMB, Department of the Treasury, and the General Services Administration (GSA). There is no clear cut responsibility for oversight and direction of financial management operations. [Ref. 25:p. 10]

Committee testimony offered three areas where follow-on legislation might or should be directed. These areas were management weakness, government accounting systems and internal controls, and audited financial statements. Specific problems identified in the testimony where a CFO might have made an impact included:

- ♦ The farm credit system.

- ♦ Federal Savings and Loan Insurance Corporation (FSLIC).
- ♦ DOD real and personal property.
- ♦ The maritime administration's vessel construction program.
- ♦ The Department of Energy (DOE) uranium enrichment program. [Ref. 1 and Ref. 18]

These areas of concern led the federal government, as noted above, to begin a series of legislative actions to establish inspectors general in major federal agencies and to set new rules for debt management, procurement, and other management practices. Some related legislation includes the Federal Grant and Cooperative Agreement Act and the Intergovernmental Cooperation Act. OMB found the federal government processes too focused on budgeting and grossly insensitive to cash management, credit management, and financial systems management [Ref. 25:p. 10].

The debate began in 1987 when Senator John Glenn, Chairman of the Committee on Governmental Affairs, introduced legislation to improve federal financial management. In his testimony Senator Glenn stated

...it was time to make someone in the executive branch provide leadership from the top. At a time when Congress is being asked to trim every program to the bare minimum, it is critical to make sure each dollar is properly spent and accounted for...My legislation would end the current policy of ad hoc financial management and ensure the Congress gets consistent, reliable financial information from all agencies...This is not blue smoke and mirrors, but a tangible investment in making sure the executive branch joins the Congress in improving the budget process at both ends of Pennsylvania Avenue....[Ref. 26:p. 5]

Comments and testimony followed first by Charles Bowsher, the Comptroller General Of the United States. His comments were that the legislation should include a

...central financial management leadership that is responsible for developing and implementing a government wide improvement plan, corresponding financial management leadership in executive branch departments and agencies, and annual preparation and audit of agency and government-wide financial statements....[Ref. 26:p. 5]

OMB Deputy Director, Joseph R. Wright Jr.'s comments were that to succeed in this monumental challenge

...the executive branch can only come from a combination of the Office of Management and Budget, working with Treasury as the lead 'line agency' to complete this massive upgrade of financial and budget systems....[Ref. 26:p. 6]

The testimony of Joseph J. Donlan, representing the Association of Government Accountants was more of a plan of action than an observation:

- ♦ The controller should be appointed without regard to political affiliation;
- ♦ The controller should be appointed for an eight year term;
- ♦ Responsibilities should include coordinating; monitoring and development of the executive agency accounting, reporting, and financial management systems;
- ♦ The controller would ensure consistency in applying principles, standards, procedures and practices government wide;
- ♦ Each department, agency, and office within the federal government would establish and assistant secretary-controller position; and

- ♦ The agency controller would be responsible for reporting to the Controller of the United States, the head of their agency, and the Congress....[Ref. 26:p. 9]

Ultimately the committees, the Senate Committee on Government Operations and the House Committee on Governmental Affairs, came to the conclusion that, in the best interest of the federal government, the OMB was the best location for the management and budget power center. It is better positioned to establish government-wide policies to achieve financial management reforms. Treasury, with its large staff at the Financial Management Service, was best suited to continue its operational support role for financial management efforts.[Ref. 18:p. 9]

With the ground work laid, Congress, spurred by the need for adequate, timely and fairly presented financial data and concerned about the apparent lack of responsible financial management in the executive branch, passed what is now known as the Chief Financial Officers Act of 1990. Principal authors were Senator Glenn and Senator Horton.

#### **E. THE CHIEF FINANCIAL OFFICERS ACT OF 1990**

At this juncture it would be prudent to begin a detailed discussion of what actually is required by the Chief Financial Officers Act of 1990. Comments on the Act during the debate prior to its passage are clear in the expectations for the Act. Senator Roth spoke of the Act as a medium "to effect change and improve the fundamental problem in the structure and operation of the federal government" [Ref. 24:p. 26]. Senator Glenn stated that the Act is "the single most important step...to reduce the risk in

the high-risk programs" [Ref. 24:p. 26]. Representative Conyers commented that the Act is "the beginning of the end of much fraud, waste, and abuse...it will create a centralized and professional leadership structure...." [Ref. 24:p. 26] All players in the development and subsequent passage of the Act felt the legislation was needed. Then President Bush, upon the signing of the Act, stated "Improving the government's stewardship over public funds is critically important" [Ref. 24:p. 26].

Then what actually has the CFO Act of 1990 done to influence a more dynamic and accountable government financial management system?

Public Law 101-576 (101st Congress, November 15, 1990), the Chief Financial Officers Act of 1990, enacted into law significant changes to the workings of the federal financial management system. The first was the establishment of the Chief Financial Officer, the first being the Deputy Director for Management in OMB, responsible for financial management in the United States Government. [Ref. 5:sect 201] Second, the Act created the Office of Federal Financial Management in OMB. This office is to be headed by a Controller who will serve as the Deputy Chief Financial Officer. Third, the Act established an infrastructure of Chief Financial Officers within the 14 departments and 9 major agencies of the executive branch. These are:

1. The Department of Defense
2. The Department of Commerce
3. The Department of Agriculture
4. The Department of Education

5. The Department of Energy
6. The Department of Health and Human Services
7. The Department of Housing and Urban Development
8. The Department of the Interior
9. The Department of Justice
10. The Department of Labor
11. The Department of State
12. The Department of Transportation
13. The Department of Treasury
14. The Department of Veterans Affairs
15. The Agency for International Development
16. The Environmental Protection Agency
17. The Federal Emergency Management Agency
18. The General Service Administration
19. The National Aeronautics and Space Administration
20. The National Science Foundation
21. The Nuclear Regulatory Commission
22. The Office of Personnel Management
23. The Small Business Administration. [Ref. 5:sect 205]

The following seven key areas became the focal point of the Act:

- ♦ Accountability standards
- ♦ Financial management organization
- ♦ Financial management personnel
- ♦ Financial systems
- ♦ Management controls
- ♦ Asset management



- Audited financial reporting.[Ref. 9:p. ii-vi]

The first, accountability standards, defined expectations for financial management in the Federal Government and provided for an objective and reliable assessment of the achievement of those expectations [Ref. 9:p. ii]. The second, financial management organizations, is intended to establish financial management organizations that will facilitate financial management improvements. At a government-wide level, an organizational structure is needed that fosters communications and cooperation among agencies confronting the same types of financial management problems [Ref. 9:p. iii]. The necessary clout, linkages to organizations and functions, and allocation of resources are a much needed features. The third, financial management personnel is the pillar for accomplishing the fundamental reforms detailed in the CFO Act. The federal government must hire the best qualified financial management personnel and train them effectively, providing the working environment that stimulates and rewards their expertise. [Ref. 9:p. iv] The next three areas of concern deal with the implementation of systems, controls, and asset management. The crux is to develop efficient, reliable measures from which to allocate scarce resources [Ref. 9:p. iv]. The final means of accomplishing the critical improvements in government finance is the publication of audited financial statement. The disclosure of this type of information will enable decision-makers to understand the financial implications of budgetary, policy and program issues. The focus is to strengthen

agency accountability for sound financial management performance [Ref. 9:p. vi].

## **F. SUMMARY**

The Chief Financial Officer of the United States is appointed by the President, with the consent and advice of the Senate and is tasked with providing overall direction and leadership to the executive branch on financial management matters and issues by establishing policies and requirements and by monitoring the establishment and operation of Federal Government financial management systems [Ref. 5:sect 202]. The agency CFO's will also be appointed by the President or designated by agency heads as required by the law. The current Federal Financial Management Status Report and 5 Year Plan, August 1994, notes that, of the 23 agencies subject to the CFO Act of 1990, OMB has approved 16 with regard to completion of their CFO structures. Implementation typically requires agency issuance of management directives and revised delegation of authority. Of the remaining 7 agencies, two have partially completed the necessary directives and delegations (USDA and Commerce), four have not yet issued documentation (AID, DOT, DOJ, and FEMA), and the last is undergoing a second reorganization (this being HUD) [Ref. 9:p. 13].

In Chapter III the focus will be a generic summary of the CFO structure, the departments and agencies that have met the guidelines of the Act, as well as the specific requirements and attributes of the CFO position. It will conclude with the current trends of the Office of Management and Budget and its impact on the Department of Defense.

### **III. IMPLEMENTATION OF THE LAW**

#### **A. INTRODUCTION**

To this point discussion has dealt with the CFO Act of 1990 and the factors that lead to the passage of the Act. There also exists a need for defining the organizational structure and the specific requirements of the Act. The focus of this chapter will be a generic summary of the CFO structure, a description of the departments and agencies that have met the guidelines of the Act, as well as the specific requirements and attributes of the CFO position and a description of current trends in the Office of Management and Budget and its impact on the Department of Defense.

#### **B. CFO QUALIFICATION**

The Chief Financial Officer of an agency is to be appointed by the President or designated by agency heads, as required by law. This individual must possess demonstrated knowledge, ability, and extensive practical experience in the financial management practices in large business or governmental entities [Ref. 25:p. 20]. The agency CFO is to report to the agency head with regard to financial management matters. The U.S. General Accounting Office (GAO), in its report of September 1991, outlined agency CFO's responsibilities as follows:

- ♦ Developing and maintaining integrated accounting and financial management systems;
- ♦ Directing, managing, and providing policy guidance and oversight of all agency financial management personnel, activities and operations;

- ♦ Approving and managing financial management systems design and enhancement projects;
- ♦ Developing budgets for financial management operations and improvements;
- ♦ Overseeing the recruitment, selection and training of personnel to carry out agency financial management functions;
- ♦ Implementing agency asset management systems, including systems for cash management, credit management, debt collection, and inventory management and control; and
- ♦ Monitoring the financial execution of the agency budget in relation to actual expenditures.[Ref. 4:p. 6]

These seven items are more specific as to the function of the agency CFO than that defined by the Act itself in section 902. The impact of these guidelines and policies are significant in that the CFOs are directed to prepare and annually revise their current assessment to the OMB for submission in the 5 Year Financial Management Plan.[Ref. 5:p. 2843] This submission will include the following:

- ♦ A description and analysis of the status of financial management of the agency;
- ♦ The annual financial statements prepared under section 3515 of the title;
- ♦ The audit report transmitted to the head of the agency under section 3521(f);
- ♦ A summary of the reports on internal accounting and administrative control systems submitted to the President and the Congress under the amendments made by the Federal Manages' Financial Integrity Act of 1982 (Public Law 97-255); and
- ♦ Other information the head of the agency considers appropriated to fully inform the President and the Congress

concerning financial management of the agency.[Ref. 5:p. 2844]

To this extent, the CFOs have been given significant authority to access all records, reports, audits, reviews, documents, papers, recommendations, or other material which are the property of the agency or that are available to the agency, or which related to programs and operations for which the CFOs have responsibilities [Ref. 5:p. 2844]. Additionally the CFOs may request such information or assistance as may be necessary to accomplish their duties.

The discussion of qualification requirements of a CFO has been sweeping, generic and generalized. The myriad of responsibilities that the CFO must possess encompasses the knowledge and experience of a comptroller, a manager, and a skilled financial management system designer, while being comfortable in the arenas of procurement, human resources and regulatory affairs. Specific standards as noted by Shields call for sufficient experience and knowledge of:

- ♦ Generally accepted accounting principles;
- ♦ Laws and regulations applicable to financial management and operations;
- ♦ Budget preparation and execution;
- ♦ Principles, preparation and auditing of financial statements;
- ♦ Financial performance standards and measurement concepts;
- ♦ Internal and management control concepts;
- ♦ Design installation and management of automated financial management systems [Ref. 25:p. 22].

These seven areas follow closely to those outlined by OMB's 5 Year Plan [Ref. 9:p. ii-vi]. The Comptroller General of the United States, Charles Bowsher, stated that

...to carry out the broad mandates of the CFO Act, agency CFO's must have demonstrated capability as influential financial management leaders, successful catalysts for bringing about change, and accomplished managers at the top levels of an organization. Also the CFO must be skilled at: (1) effectively communicating financial management objectives and issues to the agency head and other top level officials outside the financial management area and (2) applying sound judgment in planning, developing and implementing financial management systems....[Ref. 13:p. 5-6]

If an agency has an equivalent official in place who can effectively carry out the CFO role, he or she should be considered for the CFO appointment. Such an approach would serve the purposes of the CFO Act while minimizing organizational tensions. This is an important consideration that agencies must come to grips with in maintaining their flexibility and personnel investment.[Ref. 17:p. 14]

The challenge for these CFOs includes the budget execution phase. The CFO's responsibility lies in the monitoring of the execution of the budget. Concurrently, he is charged with developing and maintaining systems that integrate accounting and budgeting information [Ref. 17:p. 15]. Section 206 (A) of the law requires each agency to conduct a review of its financial management activities to consolidate its accounting, budgeting and other financial management activities under the CFO. The Act makes the CFO responsible for oversight of all financial

management activities relating to the programs and operations of the agency. Frank Hodson, OMB, felt that

...least we be tempted to interpret this language to narrowly, the act goes on to say the agency CFO will either direct and manage, or provide policy guidance and oversight of all financial management personnel, activities, and operations including the implementation of agency asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control...this is a major step in getting our financial house in order....[Ref. 17:p. 15]

The provisions establishing the CFO are the central focus of the Act, but intertwined in the fabric of the law are policies which have significant impact on how the government now will conduct business. These policies are to enhance financial management internal controls. [Ref. 25:p. 20] Now mandated by the act, as noted above, is the preparation of the five year financial management systems improvement plan; the preparation of financial statements and audits; and annual reporting to the President and Congress on the status of general and financial management in the federal government. Shields was of the opinion that agency heads now would be held accountable for their operations [Ref. 25:p. 21]. However, as noted by the current trend in the 1992 audits produced for the Federal Financial Management Status Report and 5 Year Plan, of the 19 agencies that were audited, 11 received less than the desired unqualified audit opinion [Ref. 9:p. 61-67]. Mark Goldstein, a staff member for the Committee on Governmental Affairs, commented:

... the goal, in the short term, was not to obtain unqualified audit opinions from the agencies, more

to discipline financial managers and drive the system for better, more useful, data...the balance sheet is of no value to the program manager if it is produced in a vacuum....[Ref. 15]

These sweeping changes required by the Act will not and have not come cheaply. The President's budget submission for Fiscal Year 1994 had the following request:

1. Accounting and Reporting: \$2,208 million
2. Financial Systems: \$1,602 million
3. Credit and Debt: \$2,615 million[Ref. 10:p. 3]

Compare these numbers to those of 1991 when a mere \$10 million was provided for the enactment of the law [Ref. 17:p. 8]. The approximate total to date is in excess of \$10.75 billion [Ref. 10:p. 3 and 66].

The CFO qualification is comprehensive. He or she must be a wizard at financial management, systems management and integration, and personnel management. These CFOs must demonstrate intuitive thinking, innovative management, and have a strong charismatic character, while maintaining the meticulous talents of accounting and auditing in the performance of their position. As stated previously by both Mr. Hodsoll and Mr. Bowsher, the Chief Financial Officer of an agency or department must be a leader.

### **C. ORGANIZATIONAL PROFILE**

As previously stated, OMB has responsibility for approval of each agency's and department's proposals to the CFO infrastructure as detailed in the Act. Consideration will now be given to the



functions that currently are reported to the agency CFOs. Note in Figure 1 on the following page, individual CFOs have specific reporting functions. This reporting is targeted to improve relationships with financial management components as a principal means of improving organizational effectiveness.

The Office of Management and Budget(OMB) and the agencies have noted the relationship needs between the CFO headquarter's organization and subordinate component financial management organizations as one of the most significant linkages in an effective organization. From a management culture perspective, this will be difficult to achieve for some agencies, hence, agency CFOs and OMB have devoted considerable attention to nurturing and strengthening these alliances. [Ref. 10:p. 16-17]

DOD in particular has the functional relationships of budget formulation and execution, finance operations and analysis, and financial systems [Fig. 1], all critical to the more efficient management of the department. The blueprint for improvement of DOD's financial management problem will be discussed in detail in Chapter IV. However, for clarity, Mr. John J. Hamre, DOD's Comptroller testified on April 12, 1994 before the Senate Committee on Governmental Affairs, during which he outlined his financial management reform objectives.

## FUNCTIONS OF CFO ORGANIZATIONS

AGENCY	FUNCTIONS REPORTING DIRECTLY TO CFO
USDA.....	B, F, I
Commerce.....	B, F, I, P, PR, G
DOD.....	B, F, S
Education.....	B, F, S
DOE.....	B, F, S
HHS.....	B, F, I, P, PR, G
HUD.....	****
DOI.....	B, F, I, P, PR, G
DOJ.....	B, F, I, P, PR
DOL.....	B, F, I, P, PR, G
State.....	B, F, S
DOT.....	F, I, P, PR, G
Treasury.....	B, F, I, P, PR
VA.....	B, F, I
AID.....	B, F, I, P, PR
EPA.....	B, F, I, P, PR, G
FEMA.....	B, F, G, S
GSA.....	B, F, S
NASA.....	B, F, S
NSF.....	B, F, G
NRC.....	B, F, I, P, PR
OPM.....	B, F, S
SBA.....	B, F, I, P, PR, G

### KEY:

B---Budget formulation and execution

F---Finance operations and analysis

I---Information Resources management/financial systems

P---Personnel

PR--Procurement

G---Grants management

S-- Financial Systems only

\*\*\*\*HUD Reform Act 1990

**Figure 1: Functions of CFO Organizations**

These consist of six critical elements listed as follows:

- ♦ Compliance
- ♦ Re-engineering
- ♦ Standardization
- ♦ Modernization
- ♦ Alignment
- ♦ Candor and Confidence. [Ref. 16:p. 5-9]

Mr. Hamre cited several examples during his testimony, touching on each of these objectives. These examples will be addressed in Chapter IV.

The Department of Defense has taken the implementation of the requirements for the CFO act as a priority issue. Under the direction of Secretary of Defense, Mr. Perry, DOD has established the Senior Financial Management Oversight Council (SFMOC) to deal with long standing financial problems with the intent of rectifying these problems. An example would be the practice by DOD to authorize payment on contracts from an account which is currently overobligated. Secretary Perry felt that this one item was and is a priority to be immediately addressed by this council. [Ref. 16:p. 4] These are exciting times for the Department of Defense, with budget cuts and personnel draw downs; the focusing on the financial management within the department is crucial to its survival and justification for resource allocation annually. The quicker DOD comes on line with an efficient financial management system the better positioned it will be to justify its allocation of its portion of the federal budget.

#### **D. OFFICE OF MANAGEMENT AND BUDGET CRITICAL FOCUS**

The Office of Management and Budget(OMB) has a conceptual framework for financial management improvements, which extends beyond the technical financial issues and focuses on improvement of the federal government. The framework of OMB has three major elements that bring into play seven key areas of financial management. The three elements are:

- ♦ Accountability Standards set forth where the government ought to be. Accounting standards and performance measures are the primary tools for establishing firm standards of accountability.
- ♦ Policy Guidance supports improved financial operations so agencies are capable of (1) meeting accountability standards, and (2) generating useful financial information for reporting. The principal areas in which OMB provides policy guidance are financial management organization, financial management personnel, financial systems, management controls, and asset management.
- ♦ Financial Reporting permits the government to measure and report results. Financial reporting requires agencies to (1) disclose their financial condition and results, (2) disclose the status of their financial management function, (3) provide other financial and programmatic information for decision-making, and (4) be accountable for financial management performance. The primary reporting tool is audited financial statements. [Ref. 9:p. 1-2]

This framework is built around several strategies. In principle they must proceed simultaneously. Improvement must occur at the agency level. A collective effort by OMB, agency CFOs, the Department of Treasury, GAO, the Federal Accounting Standards Advisory Board (FASAB), and the Joint Financial Management

Improvement Program (JFMIP) is an additional requirement. These strategies assume that the Administration and Congress will collaborate in providing the investments necessary to realize this change in federal financial management [Ref. 9:p. 2]. The seven critical elements alluded to above are:

- ♦ Accounting standards
- ♦ Financial management organization
- ♦ Financial management personnel
- ♦ Financial systems
- ♦ Management Controls
- ♦ Asset management
- ♦ Audited financial reporting. [Ref. 9:p. 5]

Each of these elements is discussed in detail within OMB's 5-Year Status Report. The element discussion begins with a statement of long term objectives, continuing with a statement of progress, and concluding with an outline of future improvements by category. The following pages will provide an overview of each of these critical elements to OMB's strategy.

#### **1. Accounting Standards**

It has been alleged that "the federal government is the only major entity within the United States that is operating without generally accepted accounting standards [Ref. 9:p. 5]". This is not really true in that Title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies provides very explicit standards for accounting [Ref. 27]. However widespread lack of compliance with these standards lead the Secretary of the Treasury, the Director of OMB, and the Comptroller General as the

three principals to establish the Federal Accounting Standards Advisory Board. FASAB's current progress, as of the publication of the August 1994 Federal Financial Management Status Report and 5 Year Plan, has been exceptional. The board has recommended and passed on to the principals eight standards which covered cash, fund balances with the Treasury, advances and prepayments, accounts receivable, investments in Treasury securities, accounts payable, interest payable and current liabilities. The three principals have approved the drafts and forwarded them to OMB as a statement of Federal Financial Accounting Standards in June of 1993. OMB has, in turn, issued the following Statements of Federal Financial Accounting Concepts (SFFAC) and Statements of Federal Financial Accounting Standards (SFFAS):

- \* SFFAC No. 1: Objectives of Federal Financial Reporting
- \* SFFAS No. 1: Accounting for Selected Assets and Liabilities
- \* SFFAS No. 2: Accounting for Direct Loans and Loan Guarantees
- \* SFFAS No. 3: Accounting for Inventory and Related Property. [Ref. 10:p. 9]

Performance measures are an additional issue in this category. All agencies have in the past selectively measured some performance indicators; however, the majority have been dissatisfied with the data they have been deriving. Their interest has and is focused on data which assists in budget decision making, managing programs, and assessing accountability [Ref. 9:p. 6]. OMB has issued guidance and instituted initiatives to cope

with the growing concern for performance evaluation. Some of these initiatives are:

- ♦ Financial management indicators of fiscal accountability and financial management performance with agency progress measured against established goals and routinely tracked and reported.
- ♦ Interagency Program performance measurement efforts for selecting appropriate program performance measures and presenting the performance information in annual financial statements. Common measures recommended were management of federal property, loans and loan guarantees, leases, product sales, supply operations, electric energy, medical care, health and safety regulations, enforcement regulations, market development, research and development, and working capital fund activities.
- ♦ Individual Agency program performance measurement efforts, encouraged by OMB the agencies have submitted measures developed to match program goals and objectives focusing in on financial planning, budget planning, and policy initiative planning. [Ref. 9:p. 6]

The results of these initiatives came to light during June of 1993 when the Controller announced that OMB will begin reporting on agency progress using quantitative indicators recommended by the Chief Financial Officers Council. These indicators are to be evaluated semi-annually, beginning with the period of September 30, 1993. The indicators to be evaluated are:

- ♦ Financial statement reliability
- ♦ Commercial payments efficiency
- ♦ Payroll efficiency
- ♦ Cash reconciliation timeliness
- ♦ Intra-government payment efficiency

- ♦ Reporting timeliness
- ♦ Travel payment efficiency
- ♦ Receivable management effectiveness. [Ref. 9:p. 9]

The Department of Defense has fared well with these indicators. Given the seven categories for which OMB is beginning to collect data, two have actually been reported by DOD; these are payroll efficiency and timely reporting. DOD has maintained an aggregate percentage for both these categories above 86 percent.

## **2. Financial Management Organization**

This category was discussed in Chapter II[p. 18] as to the departments and agencies which have met and complied with the Act. Figure 2 is an overview. The organizational structures for agencies and departments are currently at 16 complete and 7 in transition to an OMB approved structure. Figure 2, breaks down by agency which are complete or incomplete. Note that DOD is complete and has no outstanding actions required.

Significant progress has been made in financial management organizational structures [Ref. 9:p. 18]. The priority has been the issuance of implementing directives so that government-wide efforts now may concentrate on effectiveness rather than structure. To assist in this effort, OMB is issuing a survey tool to agency senior and program managers. This survey will enable them to understand (1) how well they are understanding the financial management aspects of their job, and (2) how well the financial management function is serving their program needs. The goal is to stimulate communication and understanding between senior and program managers and financial managers to help the



CFOs assess ways in which to improve services to their program manager customers. [Ref. 9:p. 19]

STATUS OF CFO ORGANIZATION		
AGENCY	STATUS OF REQUIREMENTS	ACTION PENDING
DOD	Complete	None
EDUCATION	Complete	None
DOD	Complete	None
HHS	Complete	None
DOI	Complete	None
DOL	Complete	None
STATE	Complete	None
TREASURY	Complete	None
VA	Complete	None
EPA	Complete	None
GSA	Complete	None
NASA	Complete	None
NSF	Complete	None
OPM	Complete	None
SBA	Complete	None
NRC	Complete	Issue Minor Directives
USDA	Incomplete	Issues Internal Directives
COMMERCE	Incomplete	Issue Department Orders
HUD	Incomplete	Under Reorganization
DOJ	Incomplete	Issue Delegation/Directives
DOT	Incomplete	Issue Directives/Appoint CFO
FEMA	Incomplete	Issue Remaining Directives
AID	Incomplete	Issue Delegations

**Figure 2:** Status of CFO Organizations

### 3. Financial Management Personnel

"Highly skilled financial management personnel are the **sine qua non** [without which not] for accomplishing the fundamental

reforms called for by the CFO's Act." [Ref. 9:p. 20] OMB feels that to attract the quality personnel needed to meet the challenge of a federal government reform in financial management requires the establishment of a personnel training management structure. Categories to be addressed by the agencies include recognition and appreciation, recruiting, training, turnover, and information transfer. The Department of Defense has begun this arduous task with a comprehensive review and restructuring of its various financial management training and education activities. It has eliminated duplicative courses, updated delivery technology and has identified new training needs oriented toward specific needs of money management. Through the Defense Business Management University (DBMU), DOD has established an advisory board to focus in on four key areas of concern; these are comptrollership, budgeting, finance and accounting, and analysis [Ref. 11:p. 2-1-4].

It is OMB's goal to develop a comprehensive and integrated program for bringing financial management personnel to the standard envisaged in the Act. OMB is forging a stronger relationship with the Office of Personnel Management to remove government-wide impediments to hiring, selecting, and retaining quality financial management talents. OMB is also working with the Department of Energy to develop an executive succession program for financial management personnel. This program will be tailored to meet the specific requirements of each agency CFO, while maintaining some internal consistency across the agencies. [Ref. 9:p. 23]

#### **4. Financial Systems**

Financial management must provide information essential for budgetary integrity, effective operating performance, stewardship, and prevention of fraud, waste, and abuse. To meet these needs, financial systems must process, track, and provide accurate, timely, internally consistent and readily accessible information on financial activity; in the most cost effective and efficient manner. [Ref. 9:p. 23] Several initiatives began in 1992. They are the initiatives to improve government-wide financial systems policies and standards; improve central agency systems; and improve agency financial systems. OMB published revisions to Circular A-127, Financial Management Systems, in July of 1993, which updated the circular for statutory and policy changes, clarified agency responsibilities, eliminated outdated guidance, clarified terminology and definitions, and eliminated unnecessary overlap between Circular A-123, Internal Controls, and Circular A-130, Management of Federal Information Resources [Ref. 7]. As a result of these initiatives the agencies and departments are planning for new systems or are making upgrades to current systems. Figure 3 and Figure 4, in descending order, summarize the current and future plans for existing applications for the federal government. Figure 4, column three is the totals for the upgrade or replacement of systems by agency. It is significant to note the trend for agencies with the most planned or underway have the least over the next five years. [Ref. 9:p. 28]

The Agencies have indicated many of their efforts to implement new systems will also examine work process, which will be critical if such efforts are to substantially improve the

## AGENCIES' FUTURE PLANS FOR EXISTING APPLICATIONS

Agency	Total Financial Management Systems	High Risk Financial Systems Areas	Total Financial Management Applications	Total
DOD	274	YES	283	557
DOT	111	YES	113	224
HUD	96	YES	96	192
TREASURY	38	YES	118	156
USDA	23	YES	102	125
HHS	12		105	117
DOI	52	YES	57	109
STATE	50	YES	54	104
AID	48	YES	48	96
SBA	16		61	77
GSA	22		47	69
VA	24		44	68
COMMERCE	28	YES	28	56
DOJ	11	YES	41	52
EDUCATION	15	YES	19	34
NASA	16	YES	16	32
DOL	13	YES	13	26
FEMA	1	YES	22	23
EPA	11	YES	11	22
OPM	5		10	15
NSF	6		6	12
NRC	5		5	10
DOE	1		7	8
<b>Grand Total</b>	<b>878</b>	<b>14</b>	<b>1306</b>	<b>2184</b>

**Figure 3:** Agency Future Plans

## AGENCIES' FUTURE PLANS FOR EXISTING APPLICATIONS

Agency	Replacement Planned or Underway	Upgrade Planned or Underway	Total Replacements and Upgrades	Number of Changes Next 5 Years	Information not Available
HUD	81	15	96	0	0
USDA	12	59	71	31	0
TREASURY	17	53	70	48	0
HHS	18	36	54	51	0
DOD	40	2	42	0	241
DOI	25	13	38	19	0
STATE	12	26	38	16	0
VA	9	29	38	6	0
GSA	5	25	30	17	0
SBA	4	25	29	32	0
DOJ	14	15	29	12	0
AID	21	2	23	25	0
FEMA	15	1	16	6	0
COMMERCE	8	6	14	14	0
NASA	12	2	14	2	0
EDUCATION	9	3	12	7	0
DOL	3	6	9	4	0
EPA	5	3	8	3	0
NSF	4	2	6	0	0
DOE	2	3	5	2	0
OPM	1	4	5	5	0
NRC	2	1	3	2	0
DOT	0	0	0	0	113
<b>Grand Total:</b>	<b>319</b>	<b>331</b>	<b>650</b>	<b>302</b>	<b>354</b>

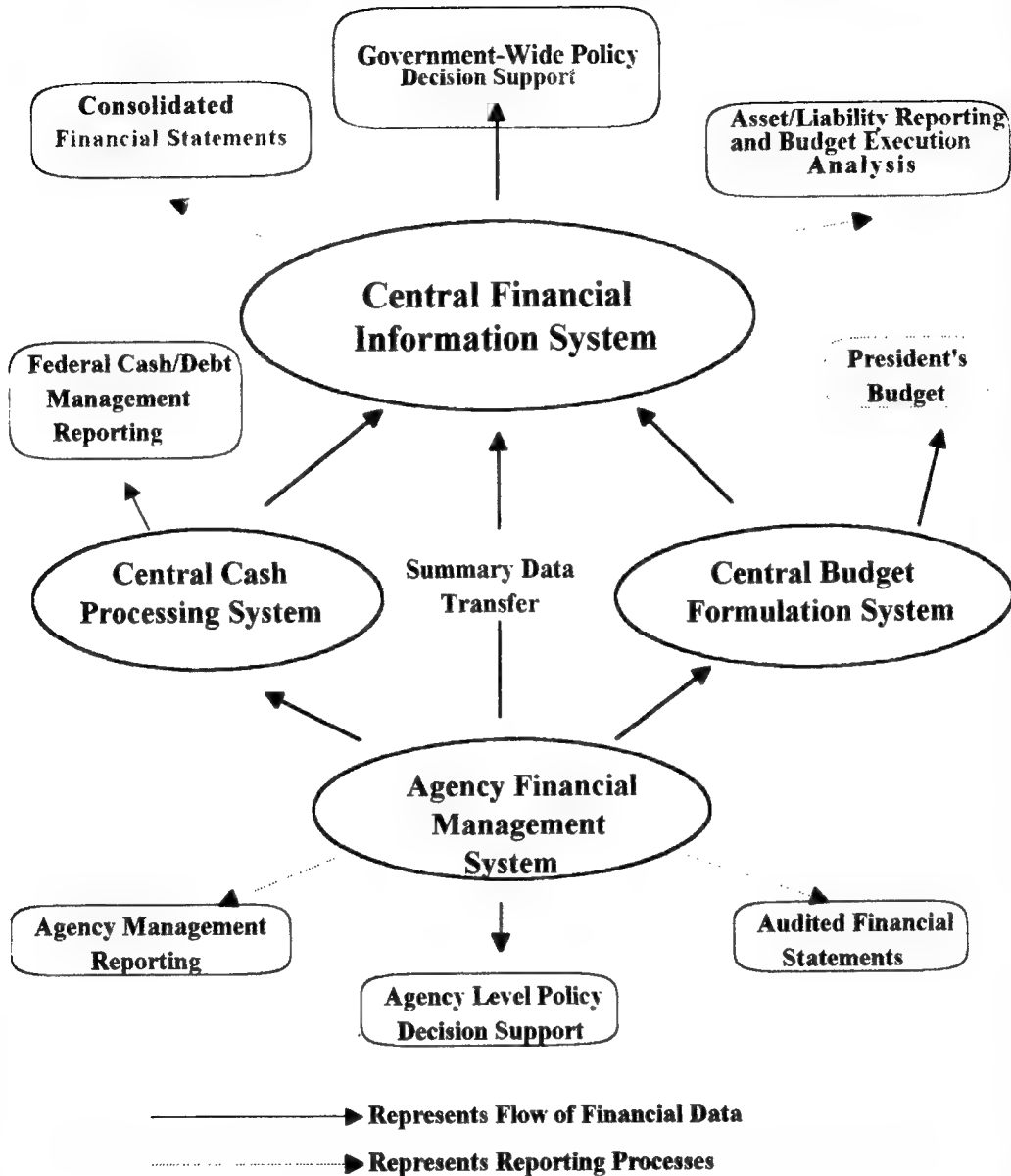
**Figure 4: Agency Future Plans**

effectiveness and efficiency of the Federal Government. Efforts to improve federal financial management systems require the integration of government-wide policy which will affect agency financial systems, thereby standardizing information and electronic data exchange between central and program agency systems. For this initiative to work, all systems must be integrated both functionally and technologically. Figure 5, on the next page is the federal government's vision for the future. It is felt that the integration of a Central Financial Information System is critical to maintain the integrity of the government's financial and performance measurement information [Ref. 9:p. 32]. Three key projects begun in 1993 by OMB include the integration of a central agency financial data base, a data dictionary for financial information, and data management functions. From a management information systems perspective, these key areas are critical to what is referred to as an Executive Information and Decision Support System. Noted also in Figure 5, the agency financial management systems are part of this vision, where the focus is on system software, consolidating of efforts, and improved monitoring of agency progress.

## **5. Management Controls**

The Office of Management and Budget defines management controls as "common sense mechanisms - ranging from written policies and procedures to systems for measuring performance that would enable the taxpayers' expectations to be met." [Ref. 9:p. 34] Agency scandals during the late 1970's and early 1980's led to the enactment of the Federal Manager's Financial Integrity Act (FMFIA) in 1982. The law requires agencies to establish systems

## Federal Financial Systems Vision



**Figure 5: Federal Financial Systems Vision**

of management controls and report any material control weaknesses to the President and the Congress. [Ref. 9:p. 34] As alluded to in Chapter II, in 1989 the Department of Housing and Urban Development (HUD) had several scandals which added up to the possibility of billions of dollars being misappropriated. The real fear of such blatant loss led OMB to produce what is now referred to as the "high risk" list. This is a list which identifies management control weaknesses that make the Federal Government vulnerable to significant loss, both from a financial perspective as well as a public policy perspective due to the avoidable loss of, or misappropriation of, federal monies. Figure 6 is a truncated example of what the agencies are doing to forestall these material weakness. The table is an accurate representation of what the agencies provided to OMB; however, OMB has some reservation as to the validity of some of the numbers reported [Ref. 10:p. 34]. The numbers are significant as to their

NUMBER OF MATERIAL WEAKNESSES					
AGENCY	REPORTED IN		CORRECTED IN		PENDING TOTAL
	PRIOR YEAR	1993	PRIOR YEAR	1993	
USDA	914	13	862	18	47
HUD	117	9	102	5	19
DOT	144	1	121	2	22
DOD	661	63	557	27	140
<b>Total</b>	<b>1,836</b>	<b>86</b>	<b>1,642</b>	<b>52</b>	<b>228</b>

**Figure 6:** Section 2 of Agency FMFIA Reports



present nature, but it must be stated that the federal government has only recently begun to audit itself and the time to improve these weaknesses in control is dependent on education and money to implement systems to manage their improvement.

Highlights of the 1993 report of agency-reported compliance on management internal control systems are:

- ♦ Overall, twenty agencies reported compliance with Section 2. Of the twenty, seven agencies (Commerce, DOD, DOE, DOI, State, Treasury and FEMA) continue to report compliance with standards for management control with the exception of material weaknesses. One agency, DOD, reports compliance with exceptions for the first time in fiscal year 1993.
- ♦ Three agencies (USDA, Education, and HUD) continue to report they are not in overall compliance with standards for management control.
- ♦ The number of material weaknesses reported for the first time in 1993 is 130. In last year's report, the number of material weaknesses reported for the first time was 198.
- ♦ The number of material weaknesses corrected in 1993 is 123. The number corrected in 1992 was 120.
- ♦ In 1993, agencies reported a total of 482 pending material weaknesses in management internal controls, which is 11 less than reported in 1992. [Ref. 10:p. 33]

These highlights are further exemplified by the progress being made in correcting high risk areas. Of the 104 which appeared on OMB's 1993 list, sufficient progress has been made in 25 areas to warrant their deletion from the list. Additionally 22 others have shown improvement, with an additional 47 areas being aggressively corrected. All told the current list with which OMB is concerned is now at 84 items.

## **6. Asset Management**

To ensure the efficient and effective use of Federal resources paid for by taxpayers, the Federal Government has developed a bifurcated strategy for the timely management of assets from acquisition to disposal. This strategy envisions the re-engineering of agency programs and operations to reduce risk and losses as well as improving agencies' capacity to manage assets in an effective and efficient manner. This includes the design and administration of loan programs, efficient collection of debts owed the Government, processing collections and payments in a timely manner and, as much as possible, the maximum utilization of electronic means.

Re-engineering credit, cash, and operations programs involves the fundamental change in the design and administration of agency credit and cash programs, including legislative and regulatory changes. The focus is in nine areas which include:

- ♦ Credit Performance Agreements
- ♦ Lender Agreements
- ♦ Credit Screening
- ♦ Federal Contractor Reporting
- ♦ Electronic Benefits Transfers
- ♦ Tax Depository System redesign
- ♦ Disbursement Practices
- ♦ Asset Management Committee
- ♦ Simplified Wage Reporting. [Ref. 10:p. 23-26]

The status and accomplishment of this re-engineering effort has been good. Under the auspices of the Government Performance and

Results Act of 1993 each agency, by 1997, will submit to the OMB and to Congress a strategic plan for program activities. The plan will cover a period of five years and state a comprehensive mission for the major functional areas, general goals and descriptions of how they will be met, an identification of key external factors beyond the control of the agency's influence and a future schedule of program evaluation.[Ref. 6:p. 286] These efforts will require a strong dedicated action by OMB, Treasury, and the agencies. The ultimate objective is improved federal program effectiveness and public accountability as well as improved congressional decision making by the focused goals outlined by the agencies.

#### **7. Audited Financial Reporting**

Agencies annual audited financial statements are crucial to the proper management of Federal dollars.[Ref. 10:p. 36] The process of preparing financial statements and subjecting them to independent audit establishes discipline in the federal financial management process.[Ref. 15] An audited financial statement provides an invaluable analytic tool for obtaining a deeper understanding of the federal agencies' financial condition and operations. It provides insight into the conduct of agencies' programs and the adequacy of their management practices, while highlighting material management problems requiring attention. In 1994 Leon Panetta testified before the Senate Committee on Governmental Affairs saying:

Let me turn to our broader management agenda, how we are pursuing a government that works better and costs less. It is true that most people's eyes glaze over at the mere mention of audited financial

statements or plans for performance measurement pilots. But without proper attention to these building blocks of government reform, efforts to restore faith in government inevitably will fail. [Ref. 10:p. 36]

Consequently OMB has devoted considerable effort to providing guidance for the form and content of agencies' annual financial statements and process for auditing these statements. OMB has provided training on:

- ♦ Understanding financial accounting used by federal agencies
- ♦ Proper techniques for preparing the financial statements
- ♦ Audit techniques--assessing internal controls, compliance measures, laws and regulations
- ♦ Use of the results from audited statements. [Ref. 10:p. 36]

The OMB is continuing to work with Congress for enactment of HR 3400, the Government Reform and Saving Act, and its provision requiring the preparation and audit annually of agency wide financial statements for all of the CFO Act agencies. The Senate is working on similar legislation, S2170, which has gone to committee and needs only be passed by the full Senate [Ref. 15]. Mr. Charles Bowsher, Comptroller General testified in January of 1994 before the Senate Committee on Governmental Affairs and stated:

I urge this Committee to act on legislative proposals that will enable even greater strides in improving government management and accountability. I believe the top priority is...completing the comprehensive foundation for financial management reform the Committee established in the CFO Act by expanding its provisions for audited financial

statements to cover all of the activities and finances of the 23 CFOs Act agencies.[Ref. 10:p. 37]

In June of 1993, OMB issued OMB Bulletin 93-18, "Audited Financial Statements" to (1) continue the requirement that the pilot agencies identified in the CFO Act submit agency-wide audited financial statements to OMB and to the Congress through 1996; (2) accelerate the submission date for the audited financial statement required by the Act from June 30 to March 1 following the end of each fiscal year in order to make them more useful for decision-making and the Congressional appropriation process; and (3) place the responsibility for ensuring the timely submission of the audited financial statements with the agency head, not just the Chief Financial Officer.[Ref. 9:p. 36]

The agencies continue to make significant progress in their abilities. The strides made in the issuance of financial statements which may be audited has been great. The data illustrated in Figure 7 on the following page is an assessment by OMB of the 1992 Audited Financial Statements. The reporting entities for which audited financial statements were required, the number of audits conducted as required and the material weaknesses in accounting controls are shown. As mentioned earlier, the growth in material weaknesses is a result of increased areas of audit and the education required in management control systems. Charles Bowsher further stated during his testimony that

...the (CFO) Act's requirement for producing annual audited financial statements, in particular, is demonstrating its value in several important ways. First, a much clearer picture is emerging of the government's true financial condition....Next, in addition to shedding light on the government's

fiscal posture, audited financial statements have brought much needed discipline in pinpointing waste, mismanagement, and possible illegal acts and in highlighting the gaps in safeguarding the government's assets....Third, CFO Act financial audits have identified actual and potential savings of hundreds of millions of dollars....Finally, the financial audits are also confirming just how little confidence the Congress and program managers can place in the information they now receive....[Ref. 14:p. 1]

<b>FINANCIAL STATEMENTS</b>				
<b>Fiscal Year</b>	<b>Number Prepared</b>	<b>Number Audited as Required</b>	<b>Number of Unqualified Opinions</b>	<b>Number with no Material Weaknesses in Accounting Controls</b>
<b>1990</b>	<b>5</b>	<b>3</b>	<b>1</b>	<b>N/A</b>
<b>1991</b>	<b>58</b>	<b>55</b>	<b>19</b>	<b>24</b>
<b>1992</b>	<b>130</b>	<b>91</b>	<b>36</b>	<b>32</b>

**Figure 7: OMB's Assessment Of Audits**

Vice-President Gore's National Performance Review (NPR) recommended that the administration issue an audited consolidated annual report on Federal Finances by 1997. OMB, Treasury, and the GAO have begun planning the necessary means to implement this recommendation. This is a monumental undertaking that will require considerable coordination between the central agencies, the CFOs, the Inspector General, and others to meet the challenge by 1997.

## **E. SUMMARY**

This chapter began with the idea of providing a generic summary of the CFO structure, the departments and agencies which have met the guidelines of the Act, as well as the specific requirements and attributes of the CFO position and the current trend of the Department of Defense. Further it discussed at length OMB's seven critical areas of focus to manage this transition in the federal government. The general consensus is that the transition is moving at the expected pace and that those agencies and departments with full implementation have begun to reap the benefits of their efforts. Chapter IV will be an in-depth analysis of these effects on the Department of Defense, the blueprint for improvement and a quick look at DOD successes and failures to date.





## **IV. DEPARTMENT OF DEFENSE IMPLEMENTATION**

### **A. INTRODUCTION**

The discussion of the Chief Financial Officers Act of 1990 has dealt with its inception and passage as a law and the specifics the Office of Management and Budget has planned and implemented to date. This chapter examines the CFO Act in the Department of Defense.

The focus of this chapter will be on the Department of Defense's initiatives. These began with the consolidation of its accounting and finance operations, the development of a corporate information management system, and the creation of the defense business operations fund. This chapter will examine the DOD's blueprint for improvement of its financial management problems outlined by the comptroller, with a conclusion dealing with future implications of the Act as well as the probability of performance audits and total entity audits of the Department of Defense.

### **B. DOD'S ACTION WITH THE PASSAGE OF THE CFO ACT**

The Department of Defense has embraced the CFO Act as a valuable opportunity to improve financial management. [Ref. 25:p. 37] DOD took the initial steps to exercise the authority provided by the CFO Act with the designation of Sean O'Keefe as its first CFO and subsequent designation of John J. Hamre the current CFO of the Department of Defense, as of November 1993. Each has had an impact on the internal workings of the Comptroller's office in the Department of defense.

Specific moves by DOD involved the consolidation of its accounting and finance operations, establishment of the Corporate Information Management program (introduced in October of 1989) and the establishment of the Defense Business Operations Fund (this action was also a precursor to the Act [Ref. 21]). These three areas were adequately discussed by Shields [Ref. 25:p. 37-71], but for continuity a general overview of each will be provided.

#### **1. Defense Finance and Accounting Operations**

On January 15, 1991, the Defense Finance and Accounting Service (DFAS) was established by the consolidation of the military departments' finance and accounting centers into a single organization under the DOD Chief Financial Officer. The intent was to provide uniform accounting policy guidance, establish requirements for financial systems, provide finance and accounting service and prepare financial statements. Its ongoing objective is the preparation of timely, comprehensive and accurate financial data through the consolidation and standardization of the Department of Defense diverse finance and accounting operations, systems and policies. DFAS has several goals which are ongoing:

- ♦ Improve service
- ♦ Consolidation
- ♦ Reduce costs
- ♦ Migratory accounting systems by FY 97
- ♦ Single DOD accounting system. [Ref. 11:p. 2-2-2-2-7]

As noted above these goals are part of the continual process improvement for DOD.

## **2. Corporate Information Management**

Corporate Information Management (CIM), introduced in October of 1989, is an initiative aimed at developing concepts for improved business processes and increased management efficiencies. The stated objective of the CIM project is to provide standardization, improve the quality and consistency of information systems, and reduce redundant systems meeting the same functional requirements. To maintain credibility and avoid the previous pitfalls of duplicative design, a CIM council was formed. The council is composed of the senior level (Flag Rank or Senior Executive Service) Information Resources Management representatives of the Office of the Secretary of Defense, the Military Departments, the Defense Logistics Agency, the Joint Chiefs of Staff, and other Department of Defense Components [Ref. 11:p. 2-1-1].

## **3. Defense Business Operations Fund**

By 1 October 1991, selected DOD industrial funds, stock funds and other commercial activities were consolidated into one Defense Business Operations Fund (DBOF). Figure 8 is a recap of the funds which have been consolidated into the DBOF. The Fund's objective is to provide a business management structure that encourages employees of the Department's support organizations to recognize and recover the costs of producing a product or providing a service and to provide products at the lowest cost [Ref. 25:p. 44]. The DBOF in simple terms is the extension of the revolving fund concept that has been in use throughout DOD for over thirty-five years. As a revolving fund, the DBOF, as detailed in the CFO Act, is required to be an audited entity. With an excess

**THE DEFENSE BUSINESS OPERATIONS FUND**  
**(FY 94 Millions of Dollars) Total 82,558**

	<b>Army</b>	<b>Navy</b>	<b>Air Force</b>	<b>Agencies</b>
<b>Supply Mgmt</b>	<b>10,061</b>	<b>6,280</b>	<b>9,776</b>	<b>11,550</b>
<b>Depot Maint</b>	<b>2,296</b>	<b>6,565</b>	<b>4,684</b>	<b>0</b>
<b>Logistic Support</b>	<b>0</b>	<b>277</b>	<b>0</b>	<b>0</b>
<b>Base Support</b>	<b>0</b>	<b>1,707</b>	<b>6</b>	<b>0</b>
<b>Transportation</b>	<b>0</b>	<b>749</b>	<b>2,940</b>	<b>5,311</b>
<b>R &amp; D</b>	<b>0</b>	<b>7,308</b>	<b>0</b>	<b>0</b>
<b>Printing</b>	<b>0</b>	<b>339</b>	<b>0</b>	<b>0</b>
<b>Informatoion Service</b>	<b>0</b>	<b>266</b>	<b>0</b>	<b>1,923</b>
<b>Distribution Depots</b>	<b>0</b>	<b>98</b>	<b>0</b>	<b>1,439</b>
<b>Reutilization</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>423</b>
<b>Industrial Plant/ Equipment</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>24</b>
<b>Financial Operations</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,653</b>
<b>Commissary</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>6,839</b>
<b>TOTAL</b>	<b>12,357</b>	<b>23,589</b>	<b>17,406</b>	<b>29,206</b>

**Figure 8:** Defense Business Operations Fund

of eighty-two billion dollars of the DOD's budget passing through the DBOF annually it, is not surprising that it would be audited.

The DBOF consists of two basic categories of activity; these are the Stock Fund Activities and the Industrial/ Commercial Activities. From an accountant's point of view, the industrial/commercial activities operate most closely to private sector business principles. The consolidation of the funds noted in Figure 8 is by design to instill a more business-like approach to the management of the Department support functions. The attention is now focused on the cost of carrying on defense operations, with the summing of the various revolving funds into one account making economical sense while raising cost consciousness. These measures have enhanced DOD's unit costing, and performance budgeting allowing for the timely tracking and reporting needed to develop fair financial statements of Defense's spending.

### **C. DOD'S BLUEPRINT FOR SUCCESS**

The Department of Defense, has, as of this year, audited a little over 60 percent of its budget authority. The entities audited include:

1. Department of the Air Force
2. Department of the Army
3. Defense Business Operations Fund
4. DOD Military Retirement Trust Fund
5. National Defense Stockpile Transaction Fund
6. DOD Education Benefits Trust Fund

7. Defense Commissary Surcharge Collections Fund
8. National Security Education Trust Fund
9. Pentagon Reservation Maintenance Revolving Fund
10. Defense Homeowners Assistance Fund
11. Defense Emergency Assistance Fund
12. Defense Security Assistance Agency. [Ref. 10:p. 52]

For the twelve reporting entities audited in 1992, the auditors issued one unqualified opinion, one qualified opinion, two adverse opinions, and eight disclaimers of opinion (i.e., the auditors were unable to determine whether the financial statement were fairly stated due to problems encountered). For these same twelve entities, the auditors also identified over fifty material weaknesses in internal controls. These results are not unexpected in light of the 1991 audit results (seven entities were audited for the first time in 1991 and none received unqualified audit opinions) and the fact that several entities were audited for the first time in 1992.

Many of the underlying problems that prevent DOD from preparing timely accurate and meaningful financial statements are systemic in nature and are of such magnitude that they will require continued and long-term commitment of DOD senior officials to remedy. Consequently, it will take several years to see the results of the various initiatives undertaken by the Department to improve financial management. [Ref. 10:p. 52]

The failings of the Department of Defense are a well known issue. In 1993 DOD made over-payments to defense contractors to the tune of \$1.3 billion, which, once discovered, was recouped. With the conclusion of Desert Storm, DOD was still paying some

1,100 personnel after they had been discharged from the service. In September of 1993 DOD was unable to match \$19 billion in disbursements to specific requirements in acquisition contracts. [Ref. 16:p. 1] These financial management failures according to John J. Hamre during his testimony before the Senate Committee on Governmental Affairs were said to

...spring ultimately from our formal organization. When DOD was established in 1947, it retained the existing organizations with their vertical chain-of-command mode of operations. This vertical chain-of-command organization is essential for success on the battlefield, but it had distinct consequences for peacetime operations...When computers came along and every organization sought to automate its processes, these organizations were not compelled to emphasize horizontal connections across organizations of like functions, such as pay or contracting...Financial management systems were designed within the chain of command to support the commander of that operation. [Ref. 16:p. 2]

Some feel DOD has created a system where no one feels it is their personal responsibility to correct the mistakes encountered and that a reluctance to change the way of doing business came, not out of a feeling that it was right to continue at the status quo, but because this practice was designed to accommodate the complexities of the overall system and the complaining that would come with any change would be bitter and persistent. These feelings being pervasive throughout DOD, lead the current CFO to adopt a six element blueprint to expedite the solving of the department's financial management problems. The six elements of the plan are:

1. Strict Compliance with current requirements

2. Re-engineering business practices
3. Standardized definitions, concepts and practices
4. Design modern finance and accounting systems
5. Align financial controls and management systems
6. Practice candor and engender confidence. [Ref. 16:p. 5-8]

The Department of Defense's Chief Financial Officer Financial Management 5-Year Plan, December 1993, specifically deals with these six points outlined by Mr. Hamre. The Department's efforts to achieve auditable financial statements are dependent on the application of adequate resources to resolve its problems.

#### **1. Strict Compliance with Current Requirements**

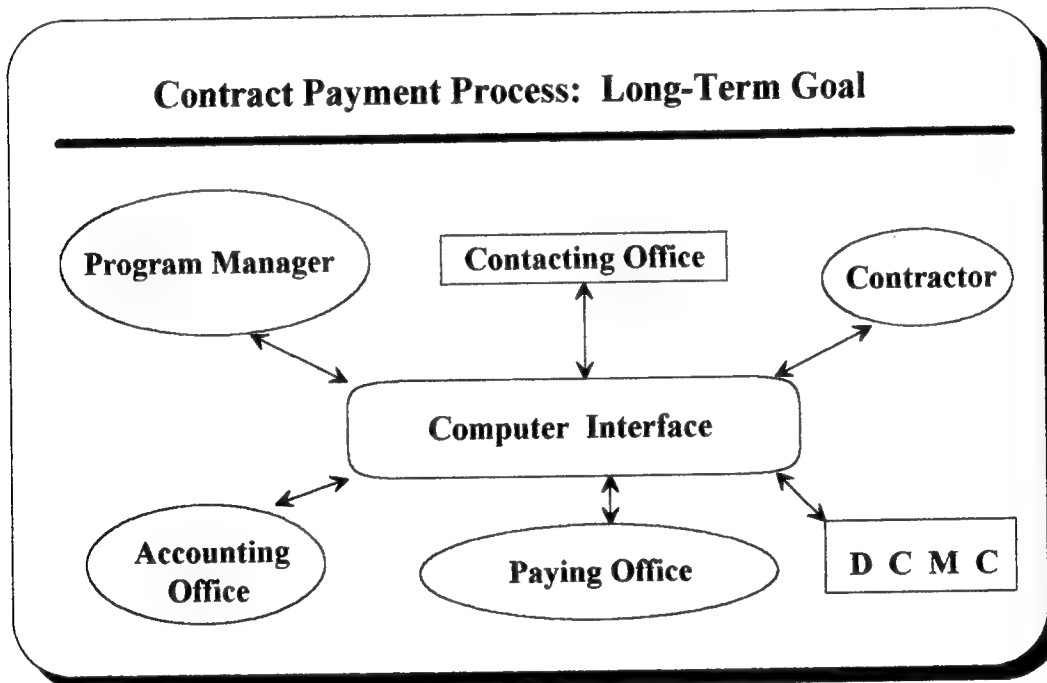
According to Mr. Hamre, the current system is inefficient and redundant, but it is the system in place and must be utilized to its full capacity until a better one can be instituted. He cites as an example of progress and improvement the aforementioned \$19 billion of unmatched disbursements noted in September of 1993. By July 1, 1994, this inadequacy had been reduced by 37 percent to \$12 billion.

#### **2. Re-engineer Business Practice**

The intent with re-engineering is to break down the barriers which persist from past legacy. It is a twofold process. The first is the short-term fix whereby, as an example, the Defense Contract Management Command (DCMC) and DFAS enter contract data into separate computers allowing for "key-stroke" errors amounting to millions of dollars. These errors are what seemed to have caused unmatched disbursements. Currently DCMC and DFAS are working to integrate their systems so that only DCMC is required



to enter the data and then it is electronically inputted in DFAS' system. In the long-term, the goal is to simplify, as an example, contract data to the point that once congressional appropriations are secured and data entry is made, then all subsequent organizations and processes can electronically borrow needed data to complete their associated tasks. Figure 9 is from Mr. Hamre's testimony and charts the desired simplification of information exchange.



**Figure 9:** Long-Term Contract Payment Process

### **3. Standardized Definitions, Concepts and Practices**

The effort toward standardization is a focus of the Corporate Information Management (CIM) project. In the financial management arena, there are currently over one hundred thousand data elements in the two hundred and fifty plus accounting systems. Computer modeling has demonstrated that the need is actually around nine

hundred elements to accomplish the full range of DOD's responsibilities. As of Mr. Hamre's testimony in July of 1994, over four hundred of the needed nine hundred standard language entries have been developed. The goal of his department is to complete this task by year's end. (1994)

#### **4. Design Modern Finance and Accounting Systems**

The establishment of the Defense Finance Accounting Service has facilitated the modernization of DOD's accounting systems. Both the military and civilian pay systems originally consisted of eighteen separate systems. As of July 1994, each has been reduced to eleven and the anticipated goal in two years is to have each functioning with but two. Currently a pay clerk for either system can service three hundred customers; in two years he is expected to handle over fifteen hundred. A down side to this modernization is in dealing with the existing sixty-six major financial systems and the one hundred and sixty one accounting systems.[Ref. 16:p. 7] Progress has been slow due to the daily use of all, but it is anticipated that future modernization will reduce this number and standardize accounting throughout DOD.

#### **5. Financial Controls and Management Incentives**

The creation of the Defense Business Operations Fund was a heroic effort begun prior to the enactment of the CFO Act. It is a system designed to capture unit cost data. The desired effect has been to ascertain true cost of repairables or replacement items. No longer are there hidden cost associated with repairs or replacement. The DBOF has introduced cost discipline to the end user that had been previously absent. Responsible personnel are now fully aware of what the cost is to

conduct business. The limiter with regard to DBOF is that the system which created it is also the system which has hamstrung its proper utilization. The end user now is paying unit costs for items which equate to DBOF's direct, indirect, and general and administrative costs; but the user's budget is not commensurate with these new costs. The upside to this new awareness for the end user is:

1. Visibility: now there is a tool to influence and control cost both at the end user level and the support establishment;
2. Flexibility: real data from which to make the hard trade-off decisions is now available, though not always fully appreciated;
3. Responsibility: a TQL notion that ownership has shifted to the lowest common denominator, resulting in greater care of expenditures and lower costs; and
4. Accountability: now there exists linkage of performance to cost management. [Ref. 14]

Figure 8, page 52, is the listing of unit cost areas.

#### **6. Practice Candor and Engender Confidence**

This final element of Mr. Hamre's blueprint is specific in the need to recognize that all that Defense wishes to accomplish in meeting the requirements of the CFO Act is dependent upon the support of Congress. He feels that to obtain the support required from Congress necessitates honest, forthright confrontation of problems, demanding candor by both Defense and Congress, as well as the confidence of both that action, the best at the time, will be taken.

## **D. DOD'S COMPLIANCE WITH OMB'S CRITICAL ELEMENTS**

The Department of Defense's blueprint for success is further re-enforced by the Department's adherence to OMB's seven critical elements discussed in Chapter III. Recall that these elements are accounting standards, financial management organization, personnel, systems, management controls, asset management and audited financial reporting. The CFO for Defense is responsible for developing policy and overseeing the implementation of financial management systems for the Department. In this sense, the financial management system referred to encompasses the seven critical areas which OMB has highlighted. The CFO is the helmsman for this continuous process improvement of financial management within Defense. The next few pages will be an overview in a similar format as in Chapter III, dealing with the accomplishments in these critical areas by the Department of Defense.

### **1. Accountability Standards**

To ensure that a project management structure and appropriate accountability are in place to achieve effective development and implementation of financial systems, the Department has created several forums to ensure the representation by and participation of top management and functional users in all phases of developmental efforts. [Ref. 11:p. 2-1-1] These forums include the following sanctioned councils, boards, groups and institutions:

- ♦ Senior Financial Management Oversight Council
- ♦ Corporate Information Management (CIM) Council
- ♦ Financial Management Steering Committee
- ♦ Defense Business Operations Fund (DBOF) Corporate Board

- ♦ Corporate Information Management (CIM) Functional Area Groups
- ♦ Defense Business Management University (DBMU). [Ref. 11:p. 2-1-1-4]

Briefly, the Senior Financial Management Oversight Council has been established to deal with existing financial management weakness as noted by Mr. Hamre and discussed in Chapter III. The CIM council provides the forum needed to improve business processes, information systems, management efficiencies and reduce redundant information systems. The Steering Committee is tasked with the development of functional requirements and facilitates implementation of product and policy recommendations concerning financial management systems. The DBOF Corporate Board monitors the implementation and operation of the fund, to include policies, rates, cash flow analysis, and criteria for inclusion of business areas in the fund. The CIM Functional Area Groups have been instituted to develop standard information requirements for specific business areas on a DOD-wide basis. The Defense Business Management University, established in 1992, is tasked with developing curricula to enhance the total professional development of the Department's work force.

## **2. Financial Management Organization**

The single most significant initiative undertaken by the Department was the development of the Defense Finance and Accounting Service (DFAS). Activated January 15 1991, by capitalizing the former finance and accounting centers of the services and the Defense Logistics Agency (DLA) under one organizational department, DFAS was established to standardize

operating procedures, ensure consistency of operations and information, streamline reporting requirements, eliminate redundancy and excessive paperwork, and stress program leadership and oversight [Ref. 11:p. 2-2-1]. Key to this tasking for efficiency and consistency is development of the Defense Standard Migration Systems. There are eight systems currently in operation or developmental implementation. They are:

1. Defense Civilian Payroll System (DCPS)
2. Defense Transportation Payment System (DTRS)
3. Defense Travel Pay Systems (DTPS)
4. Defense Joint Military Pay System (DJMS)
5. Defense Retiree and Annuitant Pay System (DRAS)
6. Defense Debt Management System (DDMS)
7. Mechanization of Contract Administration Service (MOCAS)
8. Nonappropriated Fund Central Payroll Systems (NAFCPS).  
[Ref. 11:p. 2-4-A]

These eight migration systems once fully operational are expected to replace several hundred systems currently in use.[Ref. 11:p. 2-4-1]

### **3. Financial Management Personnel**

"The financial management education and training network within the Department is a corporate asset used in support of the total professional development of the workforce." [Ref. 11:p. 2-3-1] To meet the professional development responsibilities identified in the CFO Act, the Department of Defense has begun this arduous task with a comprehensive review and restructuring of

its various financial management training and education activities. They have eliminated duplicative courses, updated delivery technology and have identified new training needs oriented toward their specific needs of money management. Through the Defense Business Management University (DBMU), DOD has established an advisory board to focus on four key areas of concern. They are comptrollership, budgeting, finance and accounting, and analysis [Ref. 11:p. 2-1-4]. To assist the Department in its endeavors for well-trained and competent personnel, each military service also sponsors advanced education for which both civilian and military employees are eligible. These include the Professional Military Comptroller School offered at Maxwell Air Force Base, Montgomery, Alabama; the Naval Postgraduate School, Monterey, California; Syracuse University, contracting with the Army, in New York; and the Defense Resources Management Institute at Monterey, California. For all the Services, the Navy is the executive agent for the Department and offers graduate level financial management programs through contract with an accredited post-secondary institution in the Washington D.C. area as well as the Naval Postgraduate School in Monterey. [Ref. 11:p. 2-3-3]

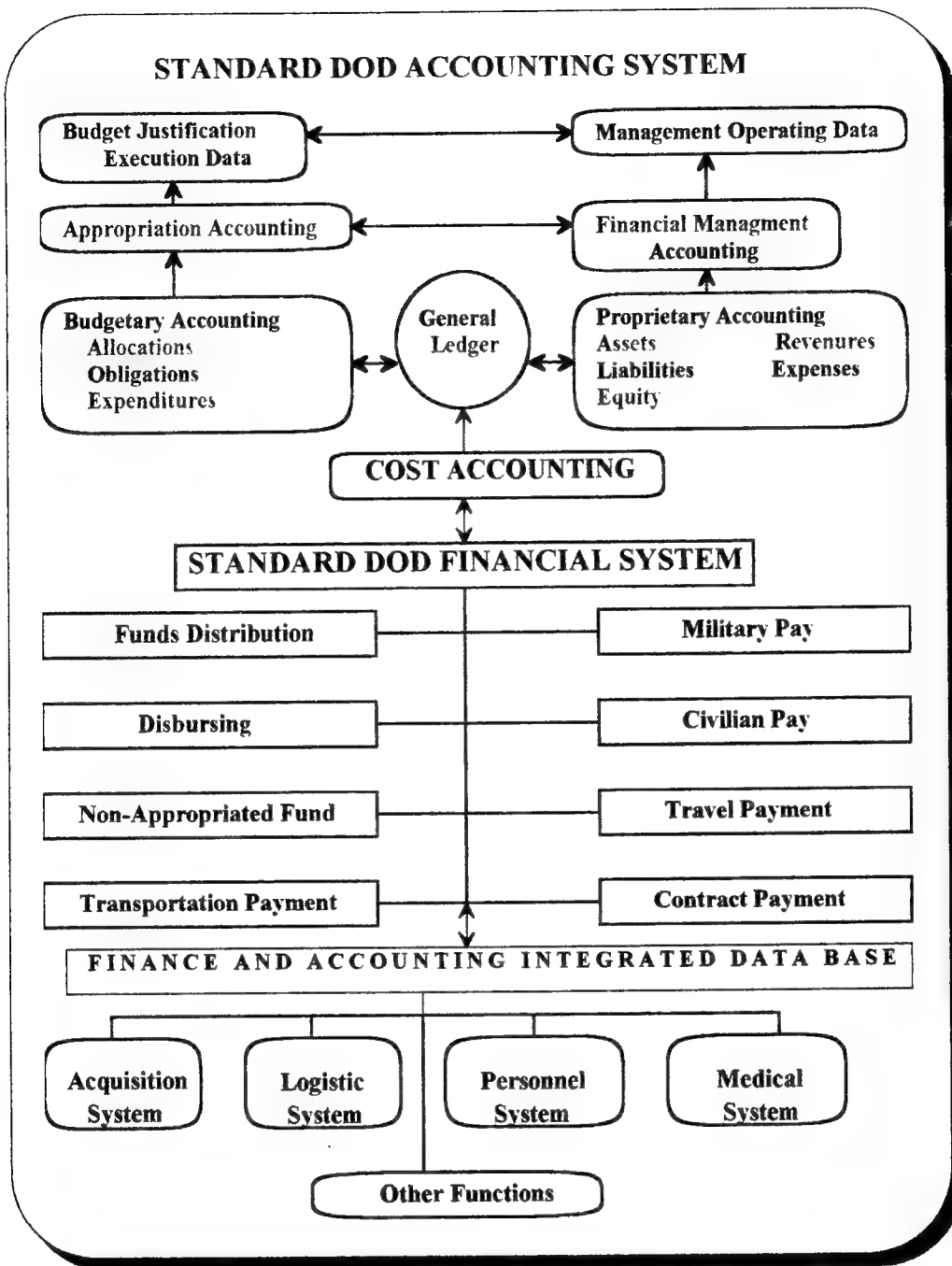
#### **4. Financial Systems**

The Department of Defense, in particular the Comptroller department, has made significant progress toward a consolidated and standardized system of operations. Key is the development of the Defense Standard Migration Systems (listed on pages 62). These eight migration systems have or are expected to have the following features:

1. Compliance: comply with statutory and regulatory requirements. Internal controls and integrity of the financial systems are maintained as well as incorporating accounting standards consistent with generally accepted accounting principles thereby simplifying existing procedures. Transaction will be processed under general ledger rules;
2. Standard Data: development of a Department of Defense Data Dictionary which standardizes the financial data definitions;
3. Interface and Integration: Financial and functional areas will be initially a two-way data flow with the goal of logical data base integration (i.e., budget, personnel, logistics, contracting);
4. Responsive to Change: functional in both a peacetime and wartime environment, the systems will be dynamic, capable of rapid response to contingency operations, legislative demands, management initiatives and other requirements set down by government;
5. Performance Indicators, Single Source Data Entry: automated indicators that measure performance, output, and customer service and associated costs. Single source data entry means that entry is by the responsible originating activity;
6. Updating and Validation: these will be at the data entry source and feedback will be automatic to all endusers;
7. Paper Optional: where ever possible data extraction, execution and validation will be via electronic means vice the hard copy of paper; and
8. Personal Property: The systems will satisfy the Department's long-term goal of reporting real and personal property at actual cost. [Ref. 11:p. 2-4-4]

The investment in these migration systems is expected to significantly reduce the cost of the Department's financial operations in the future. Figure 10, on the next page, is the





**Figure 10: DOD's Functional Architecture**

ultimate Functional Architecture which these systems are driving toward. The estimated cost for these systems annually is

estimated to be between \$65 and \$99 million over the next seven years of modification. From a business perspective this is minimal to satisfy the requirement.[Ref. 22:p. 9]

## **5. Management Controls**

The office of the DOD Inspector General and the Military Department internal audit organization have an active role in the Department's internal control program. The audit program is used to identify means to improve the stewardship of resources entrusted to the Department. The audited financial statements within DOD will serve as a means both to inform the public that, in accomplishing its mission, the Department has complied with the relevant public laws which closely resemble private sector standards. Annually the Office of the Assistant Inspector General for Audit Policy and Oversight provides the Office of the DOD Comptroller with summaries of internal control weaknesses contained in the Office of Inspector General, Military Department and General Accounting Office audit reports. These summaries include suggestions for improving the effectiveness of the internal control program.[Ref. 11:p. 2-5-3]

The additional concern which the Department has embraced is that which OMB identified as the High Risk Area. These risks have resulted from DOD's accounting systems that currently do not do the following:

- ♦ Provide adequate financial control over the department's real and personal property;
- ♦ Adequately reconcile accounting data with supporting property records;
- ♦ Accurately identify and track the cost of property; or

- ♦ Identify costs incurred to maintain and support real and personal property. [Ref. 11:p. 2-5-3]

The corrective action to eliminate the deficiencies is targeted for the FY 1996 time frame. The existing accounting systems were designed to capture the costs of acquiring material and contracting, controlling expenditures, and performance budgetary accounting. The systems were not designed to deal with proprietary accounting (assets, liability, and equity accounting data) now required for financial reporting purposes. [Ref. 11:p. 2-5-3] The CFO's intention is to effect an efficient and cost effective transition from the DOD component-unique finance and accounting system to a Department wide standard system which will embrace standard accounting principles allowing for the requisite proprietary accounting. An important aspect to this system is the integration of business requirements that cross traditional business area boundaries. Results to date indicate that progress has been made toward achieving the goal of having property transactions entered only once into an automated system, while providing access to other users of the information.

#### **6. Asset Management**

The principal action to date with regards to asset management in DOD is that, beginning in FY93 and subsequent fiscal years, major equipment items and weapons systems will be valued at the contract price of the system. Government furnished equipment or material furnished to the contractor, engineering change orders, value engineering, modifications which extend the life of the assets or extend the capability of the system and any other costs

for materials or services not included in the contract cost will be an addition to the asset's valuation. [Ref. 11:p. 2-6-3]

The remaining areas of concern for DOD are the debt collection, cash management, electronic collection and payment systems. The implementation of these systems has been the result of the 1992 DOD Inspector General audit findings that no viable systems were in place to manage these critical functions. Actions include the issuance of the government credit card for travel, guidelines for mandatory direct deposit of military and civilian pay, and standardized regulations for the recovery of personal debt due to the Department of Defense.

#### **7. Audited Financial Statements**

Mr. Keevey, the Department of Defense Deputy Comptroller (Financial Systems), in his introductory testimony before the Senate Committee on Governmental Affairs, July 12, 1994 is quoted as saying:

The true benefit to be derived by the Department from the preparation of audited financial statements is the impact that it has on the underlying financial management information maintained by the Department, and the discipline that it introduces into financial management systems and practices. In their aggregate form, the Department's audited financial statements are not used by the Department for decision making purposes. Rather, they reflect the quality of the financial information used to prepare the statements. [Ref. 22:p. 2]

He further noted that the results of the audits for fiscal year 1993 were similar to the results of fiscal year 1992. The findings of the Inspector General for the second year in a row were that inadequate internal controls and undocumented audit

trails were the contributing cause to the unreliable financial data. This was exacerbated by significant procedural and systemic deficiencies [Ref. 21:p. 4]. The financial management systems within the Department were not designed to generate auditable financial statements and they further demonstrated the diversion from generally accepted accounting principles. These weaknesses were attributed to the difficulties with

- ♦ verifying and reconciling cash,
- ♦ valuing and reconciling physical inventories to financial account balances,
- ♦ accurately reporting the value of property, plant and equipment, and
- ♦ reporting amounts in a consistent and timely manner. [Ref. 22:p. 3-4]

To remedy these weaknesses DOD has changed its Audit approach for the fiscal 1993 through fiscal 1997 years. DOD will conduct financial statement audits only when the approach is beneficial. Where the type of fund negates traditional audits or the production of statements, due to the unlikelihood that auditable financial statements can be produced for several years, the Department will conduct special audits of management data, of general and application controls, and of systems [Ref. 11:p. 2-7-3]. By fiscal year 1995, DOD anticipates that standard techniques for auditing financial statements will be used. Below is a description of these new audit approaches.

1. Management Data Audits. The audit objective under the revised approach will be to determine the availability of critical management data needed to run, evaluate and

make decisions about an activity financed by the fund. The audit work will include both financial and non-financial data. OMB has been advised of, and is receptive to this modified audit approach.

2. General and Application Controls Audits. The Inspector General will devote a team concept approach to these type audits. The specialized teams will audit the controls within computer systems that support financial accounting systems.
3. Systems Audits. Here, the plan is to perform audits of accounting and financial systems that directly support the preparation of the required financial statements. They will include audits of commercial voucher payment systems and payroll systems. [Ref. 11:p. 2-7-3]

The final improvement which DOD is working on with regard to financial audits is the institution of Performance Measures which will be linked to financial measures. This is an aggressive process which must identify program performance and measure efficiency and effectiveness with financial measures. Efficiency is measured as total cost per output. Effectiveness is identified by three categories which are:

1. The quality of the goods or service provided
2. The timeliness of delivery
3. Customer satisfaction. [Ref. 11:p. 2-7-2]

These categories should identify performance effectiveness and should measure among others the final product or service to the customer, discrete indicators, outcome goals, and be controllable, distinguishable, and automated to the fullest extent possible. In June of 1993, the Comptroller announced that after evaluating the existing guidance on performance measurement and budgeting, DOD

should expect to develop policies and procedures for performance budgeting, with the goal of integrating these measures into the budget review process to the DOD components. [Ref. 11:p. 2-7-3]

These corrections of deficiencies will require the involvement of DOD's senior leadership. They are essential to implement and execute a sound financial management strategy as envisioned by the Chief Financial Officers Act of 1990. Reform of DOD's financial management operations is a major concern of the Secretary as well as the Department's most senior leaders. Recognized by all is the need for comprehensive financial management reform to ensure that America's military strength is second to none.

#### **E. DOD'S INITIATIVES FOR THE FUTURE**

The Department of Defense has begun several efforts or initiatives to ensure future financial success for the Department. These encompass a myriad of areas, all of which are of critical importance. They include the following:

1. Revitalization of Efforts to Address Anti-Deficiency Act Violations;
2. Establishment of New Policies to Stop Expenditures for Accounts in Deficit Positions;
3. Implementation of Computer Security Initiatives;
4. Improvement of the Federal Managers' Financial Integrity Act Process;
5. Establishment of an Acquisition Financial Management Panel;
6. Improvement of Data Standardization;
7. Attack on Fraudulent Actions; and

8. Reduction, Clarification and Re-issuance of Policies.  
[Ref. 22:p. 11-26]

The Department is aggressively downsizing; recently it announced consolidation of three hundred field finance and accounting offices to twenty sites. This action is designed to facilitate the implementation of the much needed common accounting standards and operating procedures. The DOD has also published the initial volume of its "DOD Financial Management Regulations". Its intent is to centralize all financial regulations related to DOD into one publication. The goal is that it will become the single, authoritative reference for the Department Of Defense's accounting policies and procedures. The publication is to include fifteen volumes and is anticipated to be complete by January 1995.

To quote Mr. Keevey once again:

Inaccurate financial statements are not acceptable. Failure to adhere to internal control policy is not acceptable. And failure to adhere to all aspects of the CFO Act also is unacceptable...We have an agenda for reform, a long-range plan and a series of short term-initiatives aimed at reaching levels of acceptability. We have the commitment and the support of the most senior leaders in the Department...Financial Management in the Department of Defense is serious business, bringing with it the accountability and responsibility to what is right. We take this business and its challenge very seriously. [Ref. 22:p. 32]

The Department of Defense may not be in complete compliance with the Chief Financial Officers Act of 1990 but the Herculean efforts demonstrated over the past three years since its passage have been astonishing considering the archaic management systems in place and the parochial attitudes needing adjustment.



## **V. CONCLUSION**

### **A. INTRODUCTION**

The purpose of this thesis has been to investigate the Chief Financial Officers Act of 1990 and to focus on particular areas pertinent to the Department of Defense. Through analysis of available data, publications, interviews, and testimony, key concerns for the Department of Defense were addressed. These concerns have been the benefits of the reformed financial management requirements, the production of financial statements for audit, and those future plans and programs the Department of Defense has begun to institute to define its compliance with the Chief Financial Officers Act of 1990.

Research was conducted in three phases. The first, was a review of existing literature, which stimulated questions for phase 2, telephonic interviews. Key individuals at DOD, OMB, committee staff members of the House and Senate and several agency Deputy CFOs were interviewed. Altogether eight telephone interviews were completed. Phase 3 was the follow-up interviews as needed for clarification and comparison, as well as the analysis of current testimonies presented over the past several months (April-July 1994) which were relevant to the Department of Defense's initiatives. This methodology focused the thesis toward the primary and subsidiary questions expressed in Chapter I.

## **B. RESEARCH QUESTION ANALYSIS**

### **1. The Primary Research Question is:**

How have the guidelines of the Chief Financial Officers Act of 1990 been implemented within the Department of Defense?

The Department of Defense aggressively embraced the requirements of the Chief Financial Officers Act of 1990. The initial steps were to enhance internal controls for financial management within the Department. Mr. John J. Hamre modified and updated the actions taken by Mr. Sean O'Keefe, setting into motion his plan for the improvement of the Department of Defense's financial management infrastructure. His plan is to comply with current requirements, to re-engineer business practices to match appropriately those of the private sector, to standardize methodologies with the aid of computer modeling, to align controls and incentives, and to practice a more forthright demeanor when dealing with the Congress. These measures have allowed DOD to provide for improvement in its systems of accounting, financial management, and internal controls. Now DOD is assured to issue reliable financial information to forestall and deter fraud, waste and abuse of the government's allocated resources as stipulated by the law. DOD has and continues to produce auditable financial statements. These statements include not only the traditional variety but also statements presenting more imaginative management data, statements that describe general and application controls, and statements for financial systems. The Department's efforts are toward the production of complete, reliable, timely and consistent financial information that may be utilized by the

executive and legislative branches of government in their financing, management and evaluation of Department of Defense's allocations.

Key indicators of success that the Department of Defense has demonstrated for compliance are the institution of the migratory financial systems, the Defense Business Operations Fund, the Defense Finance and Accounting Service, the auditing of over 60 percent of its budget authority, and the publication of the first volume of a fifteen volume policy and procedures manual for the Department of Defense.

The eight migratory systems were discussed in Chapter IV. For clarification a migratory system is defined as the best system available as an interim measure while a fully compatible system is being developed.

The Defense Business Operations Fund, although established before the enactment of the law, has been an instrumental tool designed to instill business-like financial management aspects to DOD. The fund allows for unit costing and performance budgeting, enabling timely reporting in the production of financial statements.

The Defense Finance and Accounting Service has consolidated the Department's finance and accounting centers into a single organization and has allowed for improved service to DOD personnel (both civilian and military). The consolidation of three hundred finance and accounting sites to twenty with the intent of centralization for the improvement of service has enhanced the environment for the acceptance and utilization of the much sought after single financial management system for the Department.

Publication of the first volume of the "Department of Defense Financial Management Regulations" has been action in the correct direction. These new manuals are to become the single source publication of authoritative policies and procedures. At completion it will be a fifteen volume regulation. The full document's anticipated distribution is January 1995.

Compliance on all fronts has been the watchword for the Department. DOD has set into motion actions which allow it to adhere to the seven critical elements which OMB has issued. The future has been dictated for the Federal Government; entity wide audits are to be the standard which agencies must strive toward. The Department of Defense has noted this and demonstrated its willingness and versatility in attempting to accomplish these audits. A pilot program begun in 1993 with the audit of the U.S. Army and Air Force has been extended through 1997.

## **2. The Subsidiary Research Questions are:**

What benefits have the requirements for the annual audits produced for financial management within the Department of Defense?

The goal of an auditee is to receive an unqualified audit opinion. This opinion substantiates that the auditee has complied with generally accepted accounting principles, that the scope of the audit was in no way hindered, and that an independent auditor assures third parties that the financial statements have been presented fairly in all material respects. Materiality is the magnitude of an omission or misstatement of accounting information which would influence the judgment of a reasonable person. The concept of materiality is relevant also to an auditor's evaluation of an entity's internal control structure. A material weakness in

the design or operation of a specific internal control structure does not reduce to an acceptable level the risk that an error or an irregularity may occur or may not be detected. [Ref. 12]

The annual auditing of the Department of Defense as an entity is yet to be realized. The auditing that has occurred has been ensconced in those areas which in the initial year of the Act (1991) were areas that could be audited. Now that over 60 percent of the Department of Defense's budget authority is being scrutinized by an audit, senior management within the Department has focused its efforts on the seriousness associated with accountability. The results of the audits have been less than desired, but DOD is new to the production of auditable financial statements; moreover, many areas within the Department of Defense do not lend themselves to traditional audit methodologies, as previously discussed in Chapter IV. This process of production of financial statements in preparation for an audit has disciplined the Department of Defense, requiring a restructuring and reform of its existing systems. Adherence to the Chief Financial Officers (CFO) Act of 1990 in its requirements for audits, the Government Performance and Results Act (GPRA) of 1993 with its requirements for strategic planning of program activities, and the National Performance Review (NPR) mandates for reducing government bureaucracy have driven DOD to be better at business practices, thereby assuring accountability to the American people of its approximately 17 percent share of the Federal Budget.

How has the Department of Defense fared in meeting the seven critical elements outlined by the Office of Management and Budget?

Recall that the seven critical elements of the Office of Management and Budget (OMB) are accounting standards, financial management organization, financial management personnel, financial systems, management controls, asset management and audited financial statements. Each of these elements has elicited a response by the Department of Defense. Each is in the forefront of senior management's agenda. Mr. Hamre has published his blueprint for financial improvement within the Department and the foremost objective of his plan is the strict compliance with current requirements. Meeting these mandates of OMB is key to the success that the Department of Defense is striving for, in order to manifest full accountability to the American people.

The Department of Defense has meticulously focused on each of the elements. DOD has revised, restructured, reformed, and consolidated its infrastructure and systems; networked computers; and re-educated its personnel to better meet the principles of each element. The Department recognizes its weaknesses as well as its strengths [Ref. 22]. As shown in Figure 6 on page 40, and Figure 7 on page 46, the Department of Defense has its fair share of notable weaknesses, but when added into the fold of the Federal Government, it is part of the continued improvement in financial management.

### **C. CONCLUSION**

The Department of Defense has made significant strides in its adherence to the Chief Financial Officers Act of 1990. Many of

the programs implemented had been in process before the signing of the bill, thereby necessitating modification in action. The current CFO, his vision for the future and candor about the current limitations experienced by the Department has avoided serious confrontation with Congress, OMB, GAO or Treasury.

The Department of Defense recognizes that its "systems currently do not comply with the standards required by the Chief Financial Officers Act." [Ref. 11] To forestall any misgivings, DOD has clearly stated in its 5-Year Plan, the "Defense Financial Improvement Plan," that first on the list of improvements are automated systems development, and acquisition improvement. The Department of Defense has submitted as part of the fiscal year 1995 budget submission an \$83 million CFO Act funding requirement to develop and modify its financial systems [Ref. 21:p. 12]. Additionally, the Department is focused on policies, procedures, and compliance. Enough can not be said with regard to compliance. DOD has a record marred by actions that appear to fail to meet compliance standards. These are long-term proposals, results of which will not come quickly or easily. The complexity and magnitude of the Department's financial management endeavors can be compared to trying to plug a fire hose, with the constant stream of data on a day to day basis requiring action, but not allowing it to be arbitrarily shut off long enough to fix the situation. The CFO requirements for improvement make it ever more important that the Department of Defense continue its heroic efforts at resolving its existing deficiencies.

#### **D. AREAS OF FURTHER RESEARCH**

Automated Systems in the Department of Defense's financial management structure will be an enduring quest. The process of transition from the migratory systems currently operational or in development may require ten to fifteen years to fruition. Further research along these lines would be warranted. The evaluation of the validity of management data audits, general and application controls audits and systems audits may be worth pursuing. Analysis of the total entity audits of the differing Military Departments within DOD warrants further research. Finally continual analysis of the Department of Defense's compliance with the CFO Act as well as the expected passage of S2170, the bill mandating total entity audits by the federal government, would serve a useful purpose.



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Department of Systems Management  
Naval Postgraduate School  
Monterey, CA 93943-5002
5. Professor J. M. Fremgen, Code SM/Fm .....1  
Department of Systems Management  
Naval Postgraduate School  
Monterey, CA 93943-5002
6. Major E. Charles Buckner ..... 1  
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